IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION NO.2062 OF 2007

Diamond Services International)
Private Limited, a Company)
incorporated under the laws of)
Singapore of the Act, having)
its registered office at Unit-7)
-03, Marsh & Mclennen Centre,)
16, Cross Street, Singapore.)..PETITIONER

Versus

1.Union of India)
(Through the Joint Secretary)
Ministry of Law Justice and)
Company Affairs), Aayakar)
Bhavan, M.K. Road, Churchgate)
Bombay-400 020.)
2.The Deputy Director of Income)
Tax (International Taxation))
-1(2), Scindia House, Ballard)
Estate, N.M. Joshi Marg,)
Bombay-400 038.)
3.The Assistant Director of)
Income Tax (International)

Taxation)-1-2, Scindia House)

Ballard Estate, N.M. Joshi)

Marg, Bombay-400 038.)

Mr. Vikram Nankani with Mr. Madhur R. Baya, for the Petitioner.

Mr. B.M. Chatterji with Mrs. P.P. Bhosale and Mr. P.S. Sahadevan, for the Respondents.

CORAM : F.I. REBELLO &

R.S. MOHITE, JJ.

DATED : 12TH DECEMBER 2007

JUDGMENT (PER F.I. REBELLO, J.):

. The Petitioner is a company incorporated in Singapore and is also a tax resident of Singapore. The tax residency certificate of the petitioner has been issued by the Singapore Tax Authorities. The petitioner is a part of an international net work of companies of Rapaport Group ("the Group") which provides value added services that support the development of free, fair and competitive global diamond markets. According to the petitioners it is a foreign company and a non-resident for the purpose of the Act.

2. Gemological Institute of America (GIA) established in 1931 is the world's largest and the most respected institute of gemological research and learning. In August, 2006 GIA announced an expanded consolidation service known as GIA

'Lab-Direct' wherein it proposed to build an international network of drop-off and shipment points to assist the maximum number of clients in moving their goods to the GIA Laboratory in a safe, expedient and cost-effective way. GIA grades the diamonds and issues a certificate stating the properties such as colour, crate, etc., of the diamonds. World-wide, the certificates issued by GIA are regarded as evidence of the quality of the diamonds.

3. Indian customers interested in having diamonds graded by GIA are able to drop their stones off at the most convenient authorized "Lab Direct" consolidator/participants, who provide prompt and secure transportation to and from one of GIA's Laboratory located in USA. The role of participants/consolidators is to merely arrange the shipment of diamonds and the insurance of diamonds in transit. The entire service of the grading and certification reports for diamonds and other articles are performed from the GIA laboratories situated in USA. International Diamonds Limited, Hong Kong (IDL) has been appointed by the GIA as its non-exclusive programme participant of the LabDirect Programme. IDL has appointed the petitioner as a sub-participant of the Lab Direct Programme in respect of India. The obligations of the petitioner is to collect and ship diamonds on behalf of clients in India and collect payments from clients and make payment to GIA. GIA has appointed Rapaport India Private Limited (RIPL), an associate company of the Group as its

authorised forwarding office in India. RIPL arranges to collect diamonds, stones, etc., from Indian customers for purposes of grading and certification. RIPL levies handling charges from the Indian customers for collection and shipping of diamonds from India and re-importing such diamonds along with GIA grading reports for distribution to the Indian customers. As regards the handling charges charged by RIPL in India, the activity is carried out in India and the same is subjected to Income Tax in India and the taxability of such charges is not a matter of dispute.

4. The petitioner charges Indian customers for grading and certification reports. The Indian customers are required to make payment to the petitioners based on invoices raised by the petitioner. The payment made to Indian customers are for receiving reports and there is no technical knowledge, skill, etc. transferred by the petitioner to the customers. The inspection of the diamonds and the generation of the reports is a process which takes place entirely outside India. Under Section 195(3) of the Income Tax Act. The payee in terms of that Section has a right to apply to the Assessing Officer for the amount of certificate of payment without deduction of tax at source. Such certificate is granted if it can be established that the payment made to the payee is not liable to tax in India. The petitioner vide its representative's letter dated 17th May, 2006 had made an application to the respondent No.2 to grant a certificate under Section 197(1) of the Act to

receive diamond grading and certification charges from the Indian customers without deduction of tax at source for the financial year ending on 31st March, 2007. In the said application the petitioner had submitted the grading report charges collected by them from Indian clients cannot be said to be liable to tax as per the provisions of the Act and the Double Tax Avoidance Agreement (DTAA) between India and Singapore. The Respondent No.2 by its order dated 13th November, 2006 did not accept the contention of the petitioner and held that the activities indicate that this is a transfer of commercial experience in the shape "Diamond Grading Report" with respect to a particular diamond and is covered by definition of "Royalty within the meaning of Explanation 2(iv) of Section 9(1)(vi) and Article 12 of the DTAA between India and Singapore. and accordingly passed the consequential order. According to the petitioners the impugned order dated 13th November, 2006 was only valid upto 31st March, 1997 and was in fact passed close to the end of the Financial Year of 2006-2007. The petitioners believed that the order may be reviewed at the time of adjudicating its application for grant a certificate under Section 197(1) of the Act for the financial year ending on 31st March, 2008.

5. The petitioners on 30th March, 2007 filed an application before the respondent No.2 for grant of a certificate under Section 197(1) of the Act to receive Diamond grading and certificate charges from the Indian

customers without deduction of tax at source for the financial year ending on 31st March, 2008. The petitioners appeared before the respondent No.2 and also filed a written submission. The petitioner also appeared before the respondent No.3. The Respondent No.2 by the impugned order of 13th June, 2007 held as under:-

> "GIA does the work of Diamond Grading System. People from all over the world send their diamonds to GIA for grading and analysis. In doing grading and analysis GIA applies technical knowledge and research. Fine jewellers and auction houses consider the GIA Diamond Grading Report to be the world's premier gemological credential. The institute uses the most advanced technology available to assess, to fullest possible extent, the authenticity and quality of diamond. This information is passed on to the customers in the form of grading report. The website of GIA states that it discovers, imparts applies gemological knowledge to ensure public trust in gems & jewellery. It grade the diamonds, grade it again and then grade it again. Diamonds submitted to GIA for grading are examined by a minimum of four highly trained and experienced diamond graders and gemologist. At each subsequent step, the diamonds are independently examined by a more senior staff member. The preliminary graders assign or opinion of the diamond's clarify, polish and symmetry, then plot

necessary clarity characteristics on the diagram most representative of the diamond's shape and faceting style, which is selected from a database of hundreds of digitally stored diagrams. A second grader independently performs the above steps and depending on the various parameters as well as grading opinion agreements, the diamonds are finally graded. All the above activities indicate that this is a transfer of commercial experience in the shape of 'Diamond Grading Report' with respect to a particular diamond, and is covered under the definition of "Royalty" within the meaning of Explanation 2(iv) below Section 9(1)(vi) and Article 12 of DTAA between India and Singapore."

The petitioners aggrieved by the said order have preferred the present petition with the reliefs as prayed for.

6. Reply has been filed on behalf of the respondents by R.K. Jalali, Deputy Director of Income Tax (IT)-1(2). In the reply it is contended that diamond grading report issued by GIA is considered the world's premier gemological gradation report as they use most advanced technology to determine the quality and authenticity of diamond. The customers get this information in the form of grading report. The website of GIA states that it discovers, impart and applies gemological knowledge to ensure public trust in gem and jewellery. GIA after repeated garding and

examination by a minimum of 4 highly trained and experienced diamond graders and gemologist, who independently examine such diamonds, issues the grading report. The preliminary grader gives the opinion about the diamond's clarity, polish and symmetry, and then plot necessary clarity, characteristic on the diagram most representative of the diamond shape and faceting style which is selected from a database of hundreds of digitally stored diagrams. Second grader performs independently the above steps and depending upon the various parameters as well as grading opinion agreement, the diamonds are finally graded. All these activities, it is stated, show that this is a transfer of commercial experience in the shape of diamond grading report in respect of particular diamond and is covered under the definition of royalty within the meaning of explanation 2(iv) below Section 9(vi) and Article 12 of DTAA between India and Singapore. It is, therefore, contended that the order passed by the respondent No.2 does not suffer from any illegality and consequently the petition ought to be dismissed.

7. The issue for our consideration is whether the issuance of grading reports by GIA can be termed as impartation or granting of right to use information of a technical, commercial or scientific experience to the clients/customers who send their diamond for grading and certification to the GIA Laboratories outside India. AmericaIn order to answer the issue we will have to consider

the DTAA between the Republic of India and the Republic of Singapore. The relevant clauses for our consideration is Article 12. We may reproduce the relevant Articles which are necessary for our consideration. The relevant portion of Article 12 reads as under:-

ARTICLE 12 - Royalties and Fees for Technical Services.

1.Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that Contracting State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 10%.

3.The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of or the right to use:

(a) any copyright of literary, artistic or scientific work, including cinematograph film, or films or tapes

used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information;

(b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8.

4. The term "fees for technical services" as used in this Article means payment of any kind to any person in consideration for services of a managerial, technical or consultancy nature (including the provisions of such services through technical or other personnel) if so such services:

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein; or

(c) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.

For the purposes of (b) and (c) above, the person acquiring the service shall be deemed to include an agent, nominee, or transferee of such person."

Under the Income Tax Act, Explanation 2 of Section 9(1)(vi) defines "Royalty" is defined as under:-

"For the purposes of this clause, royalty means consideration (including any lump slum consideration but excluding any consideration which would be the income of the recipient chargeable under the head Capital gains) for

(i) - (iii).....

(iv) the imparting of any information concerning technical, industrial commercial or scientific knowledge, experience or skill;

(iva) the use of right to use industrial, commercial or scientific equipment but not including the amounts referred to in Section 44BB;

(v) the transfer of all or any rights (including the granting of license) in respect of any copyright, literary, artist or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films;"

. On a perusal of the definition of what is royalty under the DTAA and the I.T.Act, the issue which we are called upon to answer as noted earlier is whether the payment for grading certificate issued by GIA falls within the definition of "Royalty" in Article 12(3) of the DTAA between India and Singapore and/or within the definition of Royalty under Section 9(1)(vi) of the I.T. Act.

8. The grading report by GIA is a statement of fact as to the characteristics of the diamond. Does this report amount to transfer of any industrial or commercial experience of GIA to the petitioner or to an agent of the petitioner. The report gives the attributes of the diamond and includes an analysis of the diamond's dimensions, clarity, colour, polish, symmetry and other characteristics. There is nothing on record before us to show that GIA through its grade report assigns or transfers any industrial or commercial experience to its customers. Therefore, the

question would be whether the grading report would amount to any transfer of any experience by GIA to the clients. The term "experience" is not defined either under the Act or under the DTAA and consequently we shall have to consider the normal dictionary meaning. The expression "experience" in "The Oxford English Reference Dictionary has been explained as "Knoweldge or skill resulting from from actual observation of or practical acquaintance with facts or events." In "The Chambers Dictionary the expression "experience" has been explained as "Knowledge or practical wisdom gained from what one has observed, encountered or undergone". In Webster's Encyclopedic Unabridged Dictionary "experience" is explained as "The process or fact of personally observing, encountering or undergoing something." As per the dictionary meaning of the term "experience" it is clear that "experience" is a cumulation of knowledge and observation gathered over a period of time. Term "experience" has also been judicially interpreted by the Supreme Court in **Shesharao Bagde vs.. Bhaiyya reported in (1991) Supp. 1 SCC 367** as under:-

> Normally when we talk of an experience unless the context otherwise demands, it should be taken as experience after acquiring minimum qualifications required and will, therefore, necessarily have to be posterior to the acquisition of the qualification."

The grading certificate which is issued does not involve any

transfer of commercial interest to the party paying or getting the right to use the experience of G.I.A. There is also no transfer of any skill or knowledge of GIA to the customers in the issuance of grading reports. The payments received is not the one for the use or the right to use experience, but is instead one for the application of experience to a certain factual situation i.e. GIA shall apply its expertise to the diamonds submitted by the clients and determine its true feature.

. For that purpose we may consider the expression "use" as defined in various dictionaries. In the Oxford English Reference Dictionary it is defined as "Exploit for one's own ends, Employ, apply. In Chambers Dictionary it is defined to mean "Use to employ for some purpose. Apply to one's own purpose. The act so employing, using or putting into service. The nature of the transaction between GIA and its client does not invest the party making payment with any right as regards the use of the cumulated experience of GIA The payment in question does not involve a payment for the use or the right to use the industrial, commercial or scientific experience of GIA. The activity of grading or certification is merely the application of this knowledge/experience in a professional stream as applicable to a particular diamond or set of diamonds which are offered for certification or grading. The definition of royalty under the DTAA under Article 12(3) as defined therein, that uses the expression "or for information concerning

industrial, commercial or scientific experience". There is no parting of information concerning industrial, commercial or scientific experience by GIA when it issues the grading certificate. Under sub-clause (4) the payments received must be in consideration for services of managerial, technical or consultancy nature. That could include to the application or enjoyment of the right, property or information. This is not the case here. Neither is it making available technical knowledge, experience, skill, etc., to to enable the person acquiring the service to apply the technology contained therein.

9. The question that remains to be answered is whether there is imparting of specific experience by GIA to the person. Impart in Webster's Encyclopaedic Unabridged Dictionary has been defined "to give, to bestow; communicate; to grant a part or share of". In Oxford English Reference Dictionary it is prescribed as "give a share of (a thing)". A plain reading, therefore, of the meaning of the word "impart" implies that it means to give, to bestow, communicate, to grant a part or share of or give a share of a thing. Considering that the term royalty envisages grant or share of industrial or commercial experience. In other words there should be a transfer of "industrial or commercial experience" from assignor to the assignee for a consideration. Therefore, to fall within the meaning of the term royalty under Article 12 of the DTAA it must envisage the person who is the owner of any

intellectual property right, designs, or model, plan, secret formula or process, etc. to retain the property in them and permit the use or allow the right to use such patents, designs or models, plans, secret formula, etc. to another person. Where there is no transfer of the right to use, payment made cannot be treated as royalty. To be considered as royalty normally the following factors should be present in the transaction:-

(a) There should be a consideration for use or transfer of right to use;

(b) The payment shall be towards grant or share for acquiring inter-alia information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information;

(c) Such use or right to use of such property or information shall be for the stipulated period in accordance with the terms of the contract."

10. Article 12(3)(a) of the DTAA is a tax liability and as per has to be interpreted on the said principles of interpretation of taxation provisions as explained in **A.V. Fernandez vs. The State of Kerala, AIR 1957 SC 657:-**

(a) tax can be charged only if the activity sought to

be taxed falls squarely within the taxing entry;

(b) a tax cannot be imposed by presumption, inference or conjecture, but must be imposed only as per the specific language of the taxing entry.

(c) each word used in a taxing provision must be given effect to.

. Learned Counsel for both parties had submitted some orders of the ITAT for the purpose of advancing their contention that the issuance of the grading certificate can be considered as parting of commercial or technical information. None of the judgments cited are in respect of the DTAA between India and Singapore.

11. From the impugned order of the authorities what emerges is that GIA by using its experience, does the work of diamond grading. In other words parts in favour of the person seeking its specialised knowledge as to the particular diamond in the form of grading certificate. It is on account of this activity that in the order of 13th June, 2007 or for that matter in the order dated 13th November, 2006 it is set out that there is a transfer of commercial experience in the share of diamond grading report. As discussed earlier it is true that GIA may have the experience of grading. However, does it impart its experience to its client? In our opinion there is no

imparting of its experience in favour of the client. What the client receives is the report where the GIA uses its commercial or technical knowledge to give a report to the client. Illustrative example would be a lawyer giving advise to his client, a Doctor giving his medical opinion, a Laboratory submitting blood analysis report and the like. These cannot be said to be imparting of information by the person who possesses such information. What such person does is uses his experience and technical know-how for a consideration without parting with that information. In our opinion, therefore, considering the definition of royalty under Article 12 of DTAA there is no parting or rendering of technical services either of managerial, technical or consultancy nature or industrial, commercial or scientific experience. Once the consideration/fees received do not fall within the expression "royalty" the action of the respondents in refusing the certificate under Section 195 of the Income Tax Act was clearly without jurisdiction and consequently the impugned orders are set aside with a further direction to the respondent No.2 to issue the certificate as applied for by the petitioners.

12. For the reasons aforesaid Rule is made absolute in terms of prayer clauses (a), (b) and (c). In the circumstances of the case, there shall be no order as to costs.

(R.S.MOHITE, J.) **(F.I. REBELLO, J)**